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UNCLAS SECTION 01 OF 02 ANKARA 001936

SIPDIS

SENSITIVE

STATE FOR E, P, EUR/SE AND EB
TREASURY FOR U/S TAYLOR AND OASIA - MILLS
NSC FOR QUANRUD AND BRYZA

E.O. 12958: N/A
TAGS: ECON PREL TU
SUBJECT: TURKISH ECONOMY MARCH 25: TEMPORARY RESPITE ON NEWS OF US AID PROPOSAL; CONCERN ON FOREIGN EXCHANGE LIQUIDITY

REF: ANKARA 1905

Sensitive but unclassified, and not for internet distribution.

Markets Stabilize for Now

¶1. (U) Turkish markets at OOB March 25 were positively affected by press reports that the US Administration was seeking Congressional approval of $1 billion in aid as part of the war supplemental. As a result, the steady deterioration in Turkish markets of the last four days appears to have stabilized. However, traders told us that concerns about the April 9 $3 billion redemption in the local T-bill markets continue to dominate market sentiment.

-- Yields at close of the morning trading session on Turkish lira T-bills were 72 percent compounded, stronger than yesterday's close (73.5 percent), but weaker than yesterday's opening (69 percent).

-- The lira appreciated in early trading on the US news, but continuing dollar demand this morning from Turkish banks (see para 5 below) lead to renewed deprecation. The lira is currently trading at TL 1,750,000 to the dollar, unchanged form yesterday's close.

-- The Istanbul Stock Exchange closed up 2 percent, with some traders selling into the market upturn.

GOT Statement on Fiscal Tightening Largely Ignored
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¶2. (SBU) GOT spokesman Cemil Cicek's March 24 statement (reftel) outlines TL 4 quadrillion of new fiscal measures, intended to respond to heightened debt roll-over concerns. The statement didn't provide details on the measures, and market players told us late March 24 and March 25 am that the statement had no impact on the markets. "We will look to implementation," summed up JP Morgan/Chase bond trader Gumisdis.

¶3. (U) The economic portions of the March 24 statement follow:

-- "The Cabinet decided to take additional measures to prevent the impact of negative developments that might be caused by the war. We will block certain non-interest expenditures already allocated in the draft budget. This will lead to TL 4 quadrillion of savings, about 1 percent of GNP."

-- "The GOT will implement a tight cash management policy focusing only on obligatory expenditures such as public sector wages, defense expenditures and debt payments. There will be no tax amnesty or debt restructuring."

-- "We will annul the Cabinet decrees of 1996 and 2001 which prevent the forced retirement of public sector workers, and

State Economic Enterprise boards will be instructed to resolve the retirement and redundant position issues. TEKEL's privatization plan will be submitted to the High Privatization Council in a short time."

¶4. (SBU) The IMF doesn't yet have the details of the planned TL 4 quadrillion in new fiscal savings, per IMF resrep. He believes the measures are not actually "savings," but rather temporary delays of expenditures such as public investment projects, designed to generate cash now, with an eye towards the Treasury's April 9 and May 21 debt redemptions. Resrep will meet with MinState Babacan on evening of March 25 to discuss a work plan for finalizing the LOI and the Fourth Review prior actions. Resrep will brief us on March 26.

Continuing Concerns with Lack of Foreign Currency Liquidity
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¶5. (SBU) The latest vulnerability in Turkish banks lies in the declining value of their Turkish Eurobond holdings, following a large-scale foreign investor sell-off in this market. Turkish banks need such foreign exchange assets to match their foreign exchange deposits (at least 55 percent of Turkish bank deposits are in F/X). According to Barclay's Bank trader Matt Vogel, Turkish banks are currently borrowing an estimated $3 billion from foreign banks in short-term "repo" transactions (which use Turkish Eurobonds as collateral, and have an average loan maturity of 3 months). Vogel's estimate is based on demand by Turkish banks for repos loans with Barclay's, and Barclay's requirement that such banks disclose their other outstanding repo borrowing.

¶6. (SBU) The vulnerability lies in the sharply declining value of these loans' collateral, the Turkish Eurobond, which has lost about 10 percent of its value in past week and nearly 20 percent in past month. This decline has triggered margin calls among some repo lenders, which Vogel estimates to total about $300 million. Thus, he told us, Disbank (a medium size bank without a large deposit base) has been buying dollars to meet margin calls. Vogel speculates that Isbank is doing the same.

¶7. (SBU) Comment: Turkish banks' $3 billion exposure in the Eurobond repo market is not technically a "foreign exchange open position" because Turkish banks are not generally using these loans to buy lira T-bills, but rather to fund their Eurobond investments. Thus the banks are not technically "short" F/X because they have F/X denominated Eurobonds. But the problem is their Turkish Eurobonds are losing value (despite a slight increase today), and this will directly affect their ability to roll-over F/X-denominated debt in the local market in June. We are seeking the June local debt redemption dates and amounts and will provide septel.
PEARSON